NOTES.

THE COMPTROLLER'S OBJECTIONS TO CURRENCY REFORM.

THE current Report of the Comptroller of the Currency has already been subjected to some criticism. Among other things, it has been pointed out that the comptroller is in opposition, on the question of banking reform, not only to his party and its pledges, but to the weight of expert opinion in the United States. It has also been observed that in objecting to the proposed preference of the note holding creditors of failed banks, he has unduly neglected the quality of customary tender, as distinguished from legal tender, which paper of general circulation acquires in transactions between man and man. But the document thus criticised is widely circulated; the talent or experience of the persons charged with the supervision of the national banks has usually been such that their views were entitled to much respect; and the official stamp alone on the opinions advanced in the Report of 1898 is calculated to secure them an attentive hearing. It may not be amiss, therefore, again to examine those parts of the document in which are set forth the comptroller's "recommendations relative to bank currency," and "domestic branch banking," and to indicate, if such there be, the further particulars in which his argument is apparently unsound.

I.

First of all, then, it is to be regretted that the comptroller has chosen to beg the question, as well in his statement of the "assumptions" underlying the more prominent plans for a modification of the currency and banking system, as in his selection of the theses which he attempts to defend. The vast majority of those who advocate currency reform do not, it is safe to say, pretend "that unless we are to have a currency contraction, some radical extension of bank-note issues is absolutely necessary to the securing of the proper adjustment of government currency liabilities to its gold reserve." They base their case on something more respectable than the imaginary terrors of "contraction." Persons at all familiar with the theory and history of

currency know that the retirement of greenbacks or other government paper, though unaccompanied by further alteration in the present system, would cause no greater contraction than that almost imperceptible change which suffices to induce the import of gold. Once that change had occurred, the contraction would cease. As the greenbacks disappeared from circulation, gold would come in, just as in years past gold has been exported, in amounts almost exactly equivalent to those by which the sum of treasury notes of 1890 outstanding has been increased. If, accordingly, the problem were simply that of putting the treasury into better condition, the question would not be, additional bank notes or contraction, but additional bank notes or more gold. Here, however, the answer is clear, for by reason of its economy, portability and higher elasticity at the point when and where a change in its volume is needed, a well secured circulation of bank notes issued against general assets is undoubtedly preferable to one of gold. If the promoters of various schemes of reform have sometimes been at pains to show that their respective plans would not produce contraction, it has been done, not in fear of the monetary bugbear with whose name the comptroller here and elsewhere seeks to conjure, but in deference to the prejudices and loose thinking which have survived the era when greenbacks were not redeemed.

So, too, the statement of the second assumption of the currency reformers, viz., "that through this radical extension and change in the present form of bank note issues alone, is elasticity to be secured in our currency" may well be thought a trifle aside the mark. In the course of his Report, the author attempts to controvert this proposition by remarks upon the extreme elasticity of the currency based on bank deposits. That characteristic, however, the advocates of reform concede. Their arguments for change in the direction of greater elasticity relate exclusively to other money substitutes, to the circulation, that is, of notes. The comptroller's statement is therefore but a stepping-stone to the logical fallacy of equivocation or four terms.

In the "assumptions" again, on which his own suggestions are based, the comptroller seems to imply that the chief consideration urged in favor of changing the system of issue, is the possibility of shifting the burden of gold redemption from the shoulders of the government to those of the banks. Unintended as it probably was, this implication is nevertheless in ill accord with the facts. The circulation of government paper is but one of the financial evils with which the statesmen of the

country must soon begin to struggle. Even if there were no such demand obligations outstanding, the case for a thorough overhauling of our banking legislation would be scarcely less complete than it is at the present time. It is not because we have to guard against the "contraction," to which the comptroller again refers, but because the country is in imperative need of a better distribution of credit facilities, and of a more scientific and useful system of issue than it now has, that there has arisen a widespread and insistent demand for reform.

It is possible, however, to ignore the insincerity or failure to grasp the points really at issue thus indicated by the comptroller's introductory remarks, and to meet him on his own ground. Take, for example, his contention that the proposal to give the holder of paper issued against the general assets of banks a prior lien in case the issuer fails, "is not only inherently wrong and unjustified by any grounds of public policy, but that its practical effect upon the present relation of depositors to banks in the smaller communities of the United States would be so revolutionary as to bring about the most injurious conditions in the general business of the country." Little time need be wasted on the catchwords such as "inherently wrong" and the "fundamental," "sacred," or "inherent moral rights," to which the comptroller later refers in the effort to prove that the depositor in a failed bank is entitled to the same treatment as the note holder. Phrases of this sort may be useful in popular declamation or sciolistic controversy but in a practical, academic, or scientific discussion upon banking legislation, they have no place. The respective rights of depositor and note holder under a system of chartered or incorporated banks are exactly what the law—in part the common law, but in greater measure, the particular statute regulating such institutions—has declared them to be, and of this the comptroller, as a person who has practiced the profession of law, is unquestionably well aware. Whether the depositor's claim is put in the same class as the note holder's, or relegated to second place, is wholly indifferent from the ethical view; the question must be decided by considerations of expediency, of economic policy, alone.

II.

Now as a demonstration of the inexpediency of the proposed reforms, the comptroller's argument is far from perfect. It is characterized by grave faults. Some are merely technical errors of reason-

ing; others deserve no milder description than gross mistakes of fact, while a third variety, had the forecasts and predictions in which they appear come from less distinguished an author than the signer of the Report, would probably be ascribed to ignorance of the operation of monetary laws. Without attempting exactly to group the defects of the argument according to this classification, it is worth while to note:

1. That it is impossible justly to criticise the principles underlying the more important plans of reform, by merely examining their operation one by one, by simply scrutinizing the plans in detail. In first condemning the proposals with respect to issue reform and then the project to permit the conduct of branch banks in towns of more than 2000 inhabitants, the comptroller cannot demolish the schemes as a whole. Even if his objections to either of these changes were well taken, the propriety of rejecting the plan which embodies them both would not be established until it had been shown that the mutual working of these features, their joint action, the resultant of the forces which they are likely to set in motion, would fail to bring about the desired improvement in credit conditions or cause some positive harm. This, however, is a logical necessity which the comptroller has made no effort to meet.

2. The assertion that "the essential similarity between the liability of a solvent bank expressed by a deposit credit and by a bank note is generally recognized and emphasized by those advocating these plans" expresses but a part of the truth. What has been recognized by various writers on currency from Alexander Hamilton down is the essential similarity of debts on deposits or notes from the view of the bank intent on gain. Supposing the one may be created as freely as the other and is as acceptable to its customers, it makes no difference to the bank whether it buys commercial paper by writing a book credit or issuing its notes. But an extension of this similarity to all aspects and functions of the two sorts of liability such as the comptroller undertakes in his phrase "In view of this recognized similarity before the insolvency of a bank, etc.," is neither countenanced by sound doctrine nor warranted by the facts.

Under certain circumstances and for certain transactions, of course, checks and notes are interchangeably available, but in others their functions are quite distinct. If they were not, the unidentified traveler with an ample bank account would need to carry only a check book in

his pocket, and the annual outward flow of currency to move the crops could be avoided, for the most part, by the expansion of book credits with the bankers of the South and West. As things are now, those sections of the country, in which, in greater or less measure, notes form the predominating element of the media of exchange, cannot obtain increased credit so quickly or easily, when an increase is needed, as those in which checks are more largely employed. It is precisely to remedy this inequality—to give the circulation of note using sections and in consequence their credit facilities, the same elasticity which deposit using communities now enjoy—that the changes in the system of issue have been proposed.

3. As the *Bankers' Magazine* most justly observes, the comptroller has neglected the conventional necessity of accepting in payment those substitutes for money, transferable by mere delivery, of which that part of a community's circulating media is chiefly made up. Of all the fiduciary substitutes for money, not a legal tender, bank notes are most like money. When issue is profitable, moreover, and when the competition between issuers is keen, other forms of money substitutes of similar functions are likely to be expelled from the field. But when bank notes are the principal form of currency used in the smaller exchanges, many persons have practically no option whether to accept them in payment or not. A retail trader, for example, would often be forced to receive the notes by custom, and by the probability of having to lose his sale or wait for satisfaction unless he took it how and when it might be offered. Notes of particular banks might indeed be refused, but few large establishments, and much less the smaller shopkeepers and the army of artisans, would undertake to reject the notes of every bank in the national system once the changes criticised by the comptroller had been introduced. As a usual thing, the paper would be taken even if the transaction involved some risk, and the bearer of a bank note would hold a debt, which, though not of his own seeking, it was conventionally necessary to accept. The note holder, therefore, could well be called a quasi-involuntary creditor of the bank whose promise the paper bears. As a quasi-involuntary creditor, he has good and ample claim, of course, to special legal protection. The comptroller refers to Canada as the only country in which this doctrine is recognized in law; but here he errs in his facts. The note holder's priority has long been an established principle of American banking legislation, introduced by Connecticut in 1831, adopted by Ohio in

1845, by New York in 1846, by Massachusetts in 1849 and is still to be found in the statutes of Georgia, New Jersey, Massachusetts and of the federal government itself. "For any deficiency in the proceeds of all the bonds of an association, the United States shall have a paramount lien upon all its assets."[1] The principle is thus conceded, notwithstanding, in practice, it has been unnecessary to carry it out.

4. For the depositor, on the other hand, the acceptance of a bank's promise is in most cases entirely a matter of his own volition. No convention constrains him to cash the checks of persons he does not know; or to accept paper drawn upon banks he believes to be unsound. Furthermore, he is ordinarily able to pick and choose when deciding to what bank he will entrust his funds. The comptroller, indeed, implies that the depositor is "comparatively indifferent under normal conditions" to the duty of exercising great discretion in this choice, but that is a compliment to their intelligence for which the business men of the country will hardly show much gratitude. Nor will the generality thus confidently advanced serve long in explaining why the deposit lines of some institutions constantly increase, while those of other national banks stay where they long have been, or fall off, perhaps, until the bank's existence is snuffed out by the honorable method of voluntary liquidation.

It is true, to be sure, that the national government has assumed the supervision of banking institutions, but by no means true that this supervision is always properly conducted, or that the protection which it affords the depositor or public is quite complete. There are bank scandals a-plenty by which the inadequacy of the present government inspection might be shown, but the efforts of successive comptrollers to obtain amendments to the law upon inspection and supervision furnish at once an easier and more decisive proof. In any case, it is hard to believe that depositors can regard the national supervision as adequate means for detecting untrustworthiness in banks so long as, according to the admission of even the present head of this bureau, systematic violation of the law in certain particulars is systematically condoned. The prudence, experience, judgment, integrity, ability, and success of bankers, or their lack of these qualities, may become matters of common report in a business community, as easily as they reach the ears of the government inspector, or even the comptroller himself, and until such qualities are regarded as of no importance in determining

[1] § 5230 *Revised Statutes of the United States.*

the credit of men, it is likely that they will influence the depositor in his choice of a bank.

If he deals with a weak bank, because he cannot borrow of stronger concerns, the safety of the proceeds of his loans is wholly his own affair. Should the bond security for national bank notes be abolished, and the depositor object to the note holder's unqualified priority of lien, there are state banks or trust companies where his account would be gladly received. At any rate he belongs, as a voluntary creditor of his bank, in a different category from the frequently quasi-involuntary creditor on notes. His position being different from the note holder's, it is not inexorably demanded by public policy that the treatment of his claim should be the same.

5. It does not follow, because "the most important function of the national banks is that of an acting middleman (*sic*) between the depositors and borrowers of a community" that "its note issuing functions are secondary in importance and usefulness under the present or any proposed system of bank-note issues." The relative importance of the functions of the national banks, the country over, is in part only a product of natural orderly development, in part a result of the imperfections of the law. The national banking system was first called into being, let us remember, by "An Act to provide a National Currency, secured by the Pledge of United States Stocks and to provide for the Circulation and Redemption thereof." Neither in the original legislation nor the present bank act is it expressly stated that the comptroller is peculiarly charged wiih the protection of bank depositors.

If the national banks no longer provide a national currency in the sense originally intended, if their note circulation is but little more than the half of what it was twenty-five years ago, the shrinkage must be ascribed, not to a failure of function, but to the defects of issues secured by bonds, and to the unwillingness of Congress to change an antiquated system of regulation for one that would be better adapted to the times. That the volume of bank-note transactions has diminished, while every other item of the bank balances shows increase, in nowise indicates that the possibilities of issue, were issue on a rational basis permissible, have been rapidly dwindling away. Nor does a comparison of the present volume of deposits with the quantity of notes outstanding, afford a final demonstration of the superior importance of the function of deposit over that of issue In so far, in fact, as notes and checks are not or may not be interchangeably used, the importance of the two

functions ought not to be compared. The ends which they serve are distinct. Persons in one part of the country place their chief reliance upon the deposit currency; those in another, on media which pass by delivery alone, notes in short, or coin. By acknowledging in another connection that the deposit currency is not adequate to business needs in times of disturbed confidence and financial panic, the comptroller practically concedes the whole case.

6. There is reason to believe, that, whatever the new burdens imposed upon any class of depositors by the proposed preference of note holders, they will yet be able to survive. A detailed examination of the comptroller's statistical investigations must be reserved for another time. Meanwhile, however, it is interesting to note, from the comptroller's own tables, that the additional loss which would have been borne by the depositors of insolvent banks in the western states, the affairs of which had been finally closed—had the note holders enjoyed a prior lien against general assets only during the last thirty-three years, and had the note issue of banks amounted to 80 per cent. of their capital stock—is $1,719,031, or about $57,301 per annum more than the average loss, under the existing system, of $45,248 per annum on deposits reported last October at $100,865, 549. In other words the customer of the national bank in the western states would have been subjected to an added risk about equivalent to $\frac{6}{100}$ of 1 per cent. per year on the whole amount of his deposit. The chances of his losing his money within the twelvemonth would have been raised to something like one in a thousand. It is upon this class of depositors—the comptroller finds—that the real burden of the preference "will fall with almost crushing weight."

In the light of these figures, currency reformers confronted by the proposition that "in those communities in which bank depositors have already sustained the greatest percentage of losses, they are to be subjected to still greater losses" will probably still be able to preserve a moderate degree of equanimity. Even the prophecy that "the large city banks would gradually receive a larger proportion of the deposits of the country, as the increased percentage of loss to depositors of smaller banks was perceived by the general public," or the assertion that "one of the purposes of the proposed laws, which is to enlarge the circulation in those districts where it is now scanty, would be thwarted by the ultimate effect of the laws in decreasing in rural communities the deposits," is hardly calculated to overwhelm the advo-

cates of the changes with misgivings, or to convince fair-minded men that the present system should be retained.

7. How far the comptroller is justified in his alarm about the tendencies of centralization, which his tables have led him to believe are peculiar to issue upon business assets, the casual critic of these statistics can best decide for himself. It must be acknowledged, nevertheless, that it would have been interesting to learn whence so ardent an opponent of such tendencies obtained his brief, and how, with due respect to that "general business individualism" which the comptroller is apparently anxious to preserve, it will be possible to crush such tendencies out.

8. In criticising other aspects of the proposals, the comptroller has too often resorted to phrases rather than facts. In one passage, for example, there is mention of "the possibility of unusual losses in general bank assets through an inflation of the currency and resultant speculation brought about by an abnormal increase in the number of national banks." But there is no explanation of the manner in which, under the careful systems of redemption provided, the bank note circulation can thus be kept above the amounts which the business of the country requires, nor is there any description of the process by which gold exports will be prevented whenever the increase of circulating media suffices to raise the price of exchange to the point where gold can be profitably shipped. Further on, the comptroller refers to England, Germany, France, and other European nations, with their "few great state banks, and centralized business," in utter disregard of the fact that if an institution like the Imperial bank of Germany has no less than 260 establishments, in almost as many different localities, its management may be centralized, but its business certainly is not. A like indifference to essential considerations is suggested by the allusion to the Canadian banks, as "those few central institutions of eastern Canada." How well such phrases are calculated to mislead is only apparent, of course, when one remembers that the Canadian banks maintain over six hundred different places of business, and that more than two hundred of these establishments are in other provinces than Ontario and Quebec. No less than ninety, in fact, are in such thinly settled regions as Manitoba, the Northwest Territories, and British Columbia. On the whole, it is preferable to suppose that these are data of which the comptroller was not informed. As conscious misrepresentations designed to controvert the arguments drawn by cur-

rency reformers from the experience of other nations, they are neither effective, frank, nor fair.

Taken as they stand, however, their value as criticisms of the proposed revision of issue regulations is no less questionable than that of the other objections here reviewed. Exactly what shape a measure of currency reform shall be given, is still a question for debate. It is possible, indeed, that the holders of notes issued against general assets would not need the added safeguard of a prior lien—that their interests would be amply protected by a safety fund alone. But for any consideration which the Comptroller of the Currency has urged against the proposed combination of these devices, the project need not be condemned.

III.

In another passage of his Report the comptroller criticises the proposal to legalize domestic branch banking in towns of more than 2000 inhabitants. In towns of less than 2000 population, on the other hand, he recommends that domestic branch banking be permitted. "This," it is said, "would afford some smaller communities banking privileges which are now without them, but would not interfere materially with the scope of the work now so well performed by the existing banks of the smaller communities." National bankers will doubtless be pleased by so cordial an expression of approval from so high a source, but the value of the commendation is considerably lessened by what is practically a concession that a general opening of branches would interfere with their work. If the work of national banks in the several business communities of the United States were really well performed, it is hard to see what disturbance it would suffer from the introduction of branches. But if the independent local bank is not the most efficient intermediary between borrowers and lenders; if it is not the best device for facilitating, among other things, the flow of circulating capital between the persons and places of a country, there is no reason, either in public policy or the moral law, why the present inhibition of other devices should be retained.

As a matter of fact, the independent local bank is nothing of the sort, or the proposal that branches should be permitted would not be regarded by local bankers as sufficient cause for alarm. To say nothing of lesser communities, the existing lack of uniformity of interest rates among the more important money markets of the United States, constitutes what other advanced commercial nations would consider an

anomaly of the most injurious and objectionable type. Worse than that, however, it is an anomaly the origin of which is directly traceable, not to the normal operation of economic forces, but to a legal restriction, the necessity for which has long since disappeared.

The comptroller avers that the arguments for branch banking are mainly based upon the "theory" that if this practice were permitted, something more like a uniformity of rates could be brought about. A theory, indeed, it well may be, but in contrast with some of the comptroller's own, it has been based on a wide and careful observation of actual credit conditions. What the effect of branch banking will be in the United States is still, in the scarcity of material upon our early experience, a question for scientific prevision, for theorizing, if you please; but what it is and has been elsewhere, is already positively known. Scotland provides one example of its workings, England another, Germony a third, France a fourth, and Canada still a fifth. If a substantial uniformity in the rate of interest, extending to hundreds of widely separated markets, has been established in each of these countries by means of branch banking, the "theory" that like results will follow the sanction of this device by the United States is entitled to some respect.

"But," the comptroller argues, "[the consequences of branch banking privileges] would be injurious to the best interests of our country." Would that process to which he is so opposed, "the centralization of the banking business of the country in the hands of a constantly lessening number of institutions," occur as a mere iniquitous manifestation of corporate perversity, or because the large bank with branches is a better servant of its communities than an equal number of small banks, each working by itself? The "system would increase the difficulties in the way of the small borrower." But how? Is the small borrower who offers good security the less able to borrow of a branch bank than of an institution active only in the local field? Where is the evidence by which so sweeping a generalization may be proved? How is the borrower to be unduly separated from the lender under a system of branch banking, when the manifest interest of banks in the wealthy accumulating districts will be to place their representatives at every point in enterprising, borrowing communities where funds are in active demand? If a branch manager has every incentive correctly to report the local conditions of credit to his principals, and if they have no motive to overrule his judgment except when the bounds of prudence would be by him transgressed, how injurious is a

certain subordination of agents' activities to system likely to be? Where, finally, outside the comptroller's own imagination, have these interesting and obnoxious consequences of branch banking been observed?

It ought not to be forgotten that individual attention and accommodation are not the only things which customers of limited business can rightly demand from their banks. If capital is not lent as cheaply by "competing, smaller banks" to such customers, as branch banks elsewhere lend in communities otherwise similarly situated, the interests of these customers are not "now well subserved." The comptroller's bald assertion to the contrary can nowise change the case. A commonplace to the effect that "interest rates are not alone dependent upon local money supply" does not mitigate the relative disadvantage under which borrowers in all but a few of the largest American cities long have worked. Those excessive discount charges for which the remedy of branch banking has been proposed, have been exacted upon securities which would everywhere be reckoned among the best. No one pretends that "branch banks in newer communities would . . . . assume unusual risks, without unusual rates." But it is argued that they would assume a usual risk at something less than the usual local rates for the sake of attracting accounts. An enterprising bank will strive to obtain its resources through branches opened at the cheapest sources of supply and to lend them out in sections where higher rates prevail. It will have to meet active rivals in exploiting these opportunities, and through the competition of other branches the higher rates will inevitably be reduced.

According to the comptroller, nevertheless, the importance and usefulness of such a reform is incommensurate with the risks. In a method of bank organization which has elsewhere promoted equalization of discount rates, diffusion of loanable capital, and widespread extension of banking facilities, he discovers tendencies the effect of which would be the rapid concentration of American banking resources into the largest centers of trade. Just why, or how, such consequences are likely to follow, is nowhere satisfactorily explained. The details have been passed over, perhaps, the sooner to reach the conclusion: "When the economic tendencies adverse to business individualism involved in unlimited domestic branch banking are considered, the question of interest rates becomes secondary."

Here, however, any serious discussion of the comptroller's contentions might very properly cease. "Business individualism" is one of those lofty expressions which once in a while mean much, but more frequently nothing at all. Granted that the phrase is intended for something more than an appeal to ill-conceived prejudice, vaguely defined, what does it really imply? If non-interference of government, or the policy of *laisser-faire*, why forbid the banks to establish those branches, the conduct of which, as events have already proved, they would gladly undertake? If free competition, why withhold from borrowers in the southern, central and western markets the beneficent competition of lenders from the North and the East?

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DR. STEPHAN BAUER, of Brüun, Austria, editor of the *Zeitschrift für Socialund Wirthschaftsgeschichte*, is engaged to lecture on the history of economics at the University of Chicago during the coming summer quarter. The engagement is incidental to a visit which Dr. Bauer is making to this country to study the later industrial development.